Effective Mechanic's Liens on Tenant Improvements

Try to encumber the fee or ownership interest instead of the leasehold interest.

BY STEVEN NUDELMAN

Contractors, subcontractors and material suppliers need to know about statutory mechanic's liens — sometimes referred to as construction liens — in the jurisdiction where they perform work. Mechanic's liens are a critical, statutory tool to help "secure[] payment for labor or materials supplied in improving, repairing or maintaining real ... property, such as a building ... ." *Black's Law Dictionary* 1065 (10th ed. 2015).

Many times, the subcontractor does not have a contract (or contractual relationship) with the owner of the project, making the prospect of a breach of contract lawsuit against the owner dim at best. Instead, the subcontractor is relegated to filing a mechanic's lien to encumber the owner's property as security for payment to the subcontractor. The lien gives the subcontractor leverage against the owner to get paid.

While the mechanic's lien process varies from state to state, it is pretty straightforward when the owner contracted for improvement to its property. However, when the property involved is a tenant improvement, the process becomes more complicated.

Interest affected by liens

All too often a subcontractor performs work on a tenant improvement in which the owner has very little, if any, involvement. Yet the subcontractor looks to encumber the owner's real property by filing a mechanic's lien that attaches to the owner's property instead of to the lessee's leasehold interest. After all, given a choice, the subcontractor would much rather foreclose on the fee or ownership interest in real property rather than a much less valuable leasehold interest.

The subcontractor does not always have a choice, however, and courts across the country are careful to protect the owner's real property rights in the face of a prospective lien claim against a tenant. Regardless of the controlling law, a prospective lien claimant or lienor needs to understand how the lien claim process varies when the owner's lessee is the party who contracted for improvement to the owner's property. What is the impact on the lessee? The owner-lessor? The lienor?

In the recent case of *Ferrara v. Peaches Cafe LLC*, 32 N.Y.3d 348, 2018 WL 6047993 (2018), the New York Court of Appeals of New York considered these issues. Specifically, the court looked at the ability of a contractor to enforce a lien against the property owner when no direct, contractual relationship existed between the contractor and property owner. *Ferrara*, 2018 WL 6047993, at *1-4.

In *Ferrara*, the owner of a shopping plaza leased a portion of the plaza to a restaurant known as Peaches Café. Peaches Café then contracted with Angelo Ferrara to perform electrical work within the café. Peaches Café did not pay Ferrara more than $50,000 for work he had completed. Subsequently, Ferrara filed a lien on the property against not only Peaches Café, but against the owner of the entire shopping plaza. Ferrara did not have any direct dealings with the owner of the shopping plaza.

Owner involvement key

When it comes to the contractor filing a lien against the entire property owner, however, the important relationship is not actually between the contractor and the property owner. The important relationship is the one that exists between the tenant and the property owner. So for a contractor to file a lien against the property owner, the property owner must either "be an affirmative factor in procuring the improvement to be made, or ... assent to the improvement in the expectation that he will reap the benefit of it." *Ferrara*, 2018 WL 6047993, at *2.

Luckily for Mr. Ferrara, the Court of Appeals found that although the property owner was never directly involved with him, the property owner allowed and supervised the work that Peaches Café hired Ferrara to complete. The lease between the property owner and Peaches Café had explicit instructions in this regard, including that the property owner was "to retain close supervision over the work and authorized [the property owner] to exercise at least some direction over the work by reviewing, commenting on, revising, and granting ultimate approval for the design drawings related to the electrical work." *Ferrara*, 2018 WL 6047993 at *3.

The contract also included requirements including that Peaches Café "shall use only contractors approved by" and "shall not make ... any ... improvements without first obtaining the consent of" the property owner. *Ferrara*, 2018 WL 6047993, at *1. Peaches Café also had to submit the electrical plans to the property owner and had to comply with the revisions made by the property owner.

In sum, while the property owner did not directly seek out Ferrara or enter into any contractual relations with him, the property owner still oversaw the work relationship as a whole, ultimately consenting to the work done by Ferrara.

Disclaimer: This article is for informational purposes only and not to provide legal advice. Nothing in this article should be considered legal advice or an offer to perform services. The application and impact of laws may vary widely based on the specific facts involved. Do not act upon any information provided in this article, including choosing an attorney, without independent investigation or legal representation. The opinions expressed in this article are the opinions of the individual author and may not reflect the opinions of his firm.

In addition to the property owner overseeing and approving the electrical work, the electrical work actually had to have been completed to satisfy the contract between Peaches Café and the property owner. According to the contract, Peaches Café had to have been open and running seven days a week during specific hours. The contract also included that Peaches Café "shall retain competent and skilled contractors for the completion of" the electrical work and it cannot open for business until it "completes the improvements according to the lease term." Ferrara, 2018 WL 6047993, at *1.

Likewise, if the electrical work was not completed, Peaches Café would not be able to abide by the requirements of its contract. Thus, the lease not only allowed the work to be done, but actually required it. This further established the property owner's consent to the work performed by Ferrara and established an ability for Ferrara to file a lien against the business owner.

The catches

Just because an owner knows about the improvements or repairs being made does not necessarily mean the owner is consenting to the work to be done. The owner needs to affirm the work being done. Additionally, if the contract between the landlord and tenant requires certain improvements or repairs to be completed and the tenant does additional work to the premises not included in the contract, the owner of the property cannot have a lien filed against it by the hired contractor for the additional work. However, the owner can potentially have a lien filed against it for the work consented to by the owner.

Finally, it is important to note that the above "catches" pertain to New York lien law only. Each state has its own picayune requirements — predicated on case law and statutes — and it is not safe to assume that the law in one state is the same as the law in another state. However, the underlying principles and cautions regarding liens on leaseholds and fee interests apply in every jurisdiction.

A direct, contractual relationship between a landlord business owner and a third-party contractor may not be needed for a contractor to file a lien action against the landlord. While the lien laws differ from state to state, the goal for a contractor or subcontractor wishing to file a mechanic's lien is the same: Try to encumber the fee or ownership interest instead of the leasehold interest.

While liens are a frequent do-it-yourself project for an entrepreneurial subcontractor, it is much more prudent to consult a construction attorney in your jurisdiction if you are considering filing a lien. Many states have statutory penalties if prospective lien claimants fail to comply with the lien laws. The smart subcontractor will avoid this minefield and seek appropriate legal counsel before moving forward with the mechanic's lien process. ●

Steven Nudelman is a partner at the law firm of Greenbaum, Rowe, Smith & Davis LLP in Woodbridge and Roseland, N.J. He is a member of the firm's Litigation Department and its Construction, Community Association, Alternative Dispute Resolution and Alternative Energy and Sustainable Development Practice Groups. He may be reached at 732-476-2428.